

The Fairfax City Economy: Its Current Performance and Near-Term Outlook

By

Stephen S. Fuller, Ph.D.
Dwight Schar Faculty Chair and University Professor
Director, Center for Regional Analysis
George Mason University
Fairfax, Virginia
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Introduction

The Fairfax City economy is under pressure from global, national and regional forces that are testing its resilience and having short-term consequences that at present may obscure the City's long-term outlook. The current economic distress that has been so evident is moderating and the local and national economies are expected to emerge later this year from this worst economic crisis since WW II. These challenging times provide a good frame of reference from which to examine the City's economy and to assess the successes and failures of past policies and strategies that have been guiding the City's economic development and growth and have positioned it for the next business cycle.

How has the City's economy performed during the current downturn? Has it passed the "stress test?" What are the City's sources of economic growth and how will these perform in the future? Has the City missed important opportunities to position itself for future growth? These are important questions and the timing could not be better for exploring them and others and to consider what the City's alternative economic futures might be and what can be done to better assure that the City economy is ready for the next business cycle. The objective of the following analysis is to frame this discussion.

Current Economic Conditions

The U.S. economy is in its 18th month of the current recession and the early signs of improvement are just being detected. This recession, which began officially in December 2007, is likely to continue until the last quarter of 2009 making it the longest recession since the recession of 1947-1949. It will also be the deepest one-year decline in GDP since 1948, with GDP projected to contract by 3.5% in 2009.

While there are some important signs that the recessionary conditions are beginning to abate (consumer expectations are rising, initial claims for unemployment insurance are increasing more slowly on a weekly basis, industrial orders and the ISM Manufacturing and Non-manufacturing Indices have begun to

move up, existing housing sales are increasing), the recovery will be slow and extend into 2011. Payroll job growth, which has declined by more than 5 million workers over the last 12 months, is not expected to turn positive until mid-2010 and unemployment, which is projected to reach 10.2% by mid-2010, will not decline to near-normal rates until after 2014.

The Washington area economy is feeling the effects of this national recession but appears to be avoiding actual contraction benefiting from the counter-cyclical expansion of its principal core sector, the federal government, and its related national capital functions. Still, unemployment is rising in the Washington area (5.8% in March) and employment is declining with payroll employment down by 18,300 jobs between March 2008 and March 2009. Still, this 0.6% decline in payroll employment is small compared to the 3.5% decline in payroll employment nationally. Unemployment in the Washington area has almost doubled in the last year but remains the lowest in the U.S. among major metropolitan areas.

Even though there has been net job losses in the region, the economy's major employment sectors—professional and business services, federal government, and education and health—are still adding jobs and the jobs these sectors are adding have substantially higher incomes than the jobs the area's economy is losing in retail, construction, financial services, manufacturing, information services, and wholesale trade. As a consequence of this employment shift to higher valued-added jobs, the Washington area economy has continued to expand although the projected 1.2% growth this year would be the smallest since 1991.

The Northern Virginia economy is more elastic than either the District's or Suburban Maryland's and therefore tends to expand faster in boom times and adjust more rapidly during downturns. Over the past fifteen years, the Northern Virginia economy has been generating new jobs more than twice as fast as Suburban Maryland and has accounted for approximately 45% of the Washington area's total growth. The driver behind Northern Virginia's strong growth has been its dominance of federal contracting dating back to the early 1980's. Over the past 28 years, firms located in Northern Virginia have accounted for just under 50% of all federal contracting dollars in the metropolitan area with this percentage reaching 54% and totaling \$35.9 billion in 2008.

Still, the Northern Virginia economy has slowed significantly during the past year and has experienced both decreases in payroll employment during the year's first quarter and increases in unemployment. However, due to the favorable structure of the local economy it is expected to reaccelerate more quickly than in the District of Columbia or Suburban Maryland. Economic growth in the Washington area is also expected to accelerate several quarters sooner than at the national level. These projected growth rates are shown for the U.S. and Washington region's sub-state portions in Table 1.

Table 1

Economic Growth in the Washington Area by Sub-State Area: 2007-12
(inflation adjusted annual percent change)

Year	US	Washington Metro Area	District of Columbia	Suburban Maryland	Northern Virginia
2007	2.2	3.1	2.5	3.6	4.1
2008	1.1	2.2	2.0	2.1	2.4
2009	- 3.5	1.2	1.0	1.1	1.4
2010	1.4	3.1	1.5	2.3	4.4
2011	3.5	3.8	2.5	3.3	4.7
2012	4.0	4.3	3.1	4.1	5.0

Source: GMU Center for Regional Analysis

The structure of the Washington area economy and the differences and interdependencies within the sub-state economies provide the context for their more localized economies; that is, the Fairfax City economy's performance and outlook are not independent of its surrounding economies. Therefore, it is important to understand this economic framework and its expected performance going forward.

Fairfax City's Economic Base

The Fairfax City economy consists of two primary markets: the residentially based market and the non-local market or export base. The residentially based market is driven by the spending of City residents and therefore is a function of the number of residents and/or households, their disposable income, and the ability of local business establishments to capture locally generated consumer spending.

The non-local market or export base reflects the City's economic activities that are supported by sales to non-local residents. This market includes the hospitality sector as visitors to the City, either day-trippers or over-night, spend money in the City that is earned elsewhere. This market also includes federal contractors and other professional and business services, and retail activities catering to markets that are not dependent on resident demand. Even though GMU is not within the City limits, its contiguous location affords the City economic opportunities of an export nature (spending that does not originate within the City) as do other nearby activities whose economic activities may spill over to the benefit of the City.

The City's economic structure has evolved over time with its residentially supported business base eroding during the 1980's and into the 1990's as its competitive

position declined in response to the emergence of easily accessible regional retail centers in surrounding areas. This loss of retail and consumer services undercut the City's economy at a time when its non-residentially dependent business base was growing. As the City's residential base grew during the 1990s and through the current decade, its market potential has increased. This growth of disposable income among the City's residents has supported the redevelopment of the City's center although the re-emergence of the City's retail core is not yet complete.

While the City's constrained geographic size and residential character have limited its ability to compete for non-locally dependent businesses, it has succeeded in attracting office uses along major corridors. Still, the City cannot compete with Tysons Corner or Reston for the high-density office uses. Rather, the City's office market is a niche market reflecting buildings with smaller footprints and heights and lower rental costs. The City's office market is different from larger, higher density and more expensive markets and these differences can become an advantage that can be marketed to businesses that are seeking the distinguishing conditions available in Fairfax City and not found in other nearby markets.

Residentially Supported Market

The residentially supported market in Fairfax City has changed significantly since 2000. Between 2000 and 2007 (the last year for which data are available) the City's population increased from 21,498 to 23,349 for a gain of 8.6%. This growth rate was approximately the same as for the State for this period. During this same period a total of 735 new houses and apartment units were built accounting for 8.5% of the City's housing stock. While these gains in total population and households are important to the economy's growth over the 2000-2007 period, they do not explain the full increase in total personal income that the City achieved during this seven-year period when it increased from \$688.5 million to \$963.6 million for a gain of 40 percent.

This dramatic increase in personal income resulted from migration: City residents moving out and being replaced by new residents. During this seven-year period, the U.S. Census estimated that of the 8311 households residing in Fairfax City in 2007, 4,102 or 49.3 percent moved in between 2000 and 2007. While some of these new residents moved into the 735 new housing units built during that period, most moved into existing units (bought or rented) that had been previously occupied.

As a result of the rapid rise in housing values over this period, it was normal that the households moving into the City would have higher incomes than the households moving out. The net result of this shift in the City's population (a combination of growth from an expanding housing stock and newcomers moving in and replacing old time residents) has significantly increased the residentially based retail market potential in the City and therefore its ability to support a growing retail base. These population and income trends are shown in Table 2.

Table 2

Population and Income Trends in Fairfax City, 2000-2007

Indicator	2000	2007	% Change
Population	21,498	23,349	8.6
Households	8,035	8,311	3.4
New Housing Units		735	8.5
New Households		4,102	49.3
Per capita Income	\$32,028	\$41,271	32.1
Personal Income*	\$688.54	\$963.64	40.0

Sources: U.S. Census, GMU Center for Regional Analysis

*in millions of current year dollars

Fairfax City residents constitute an important economic force. The residents with jobs (12,370 in 2007) work largely outside of the City and bring their earnings back to the City to be spent on consumer goods and services. With an average household income of \$108,311 in 2007 this income represents a significant market potential for local-serving businesses.

Non-Local Business Base

The non-local business base has always been an important component of the City's economy. Historically, the City served as a market center for surrounding farmers and as the seat of County government. In more recent years, some of these historic functions have relocated or disappeared altogether while others have emerged. Primary among the City's new core sectors are: hospitality (which includes business and leisure visitors as well as entertainment, culture and restaurants), education (GMU), federal contracting, and region-serving business services.

The key asset the City has to offer its non-local serving businesses is centrality with identity. While the City's regional location is good, there are many centers in Northern Virginia with equal or better access. What Fairfax City has that few other competing locations offer is a city environment. Fairfax City is a place in a region without many identifiable places. It has history, an understandable scale, qualities and amenities that reinforce its sense of place, a university center, and a vibrancy resulting from the interdependences of its reinforcing functions that is not common in Northern Virginia. "Small is beautiful." The redevelopment of the downtown commercial center provides the City the capacity to capture an increasing share of its local business and retail potential that in the past had been lost to retail centers in adjacent areas. The growth of the City's business base is shown in Table 3.

Table 3

Fairfax City Businesses By Type: 2000-2006

Business Data	2000	2006	% change
Number of Firms	2,212	2,450	10.8
Number of Employees	32,357	38,041	17.6
Payroll (in millions)	\$1,467.7	\$1,953.7	33.1

Source: U.S. Census

Over the 2000-2006 period, the number of business establishments in the City increased almost 11 percent while the number of workers employed in the City increased by almost 18 percent and their annual payroll increased by 33 percent. Over this period, the City's businesses grew in both number and size, but more importantly, their mix changed, as more, higher valued-added firms were attracted to the City.

This changing mix of the City's businesses, which is shifting to larger employers with a higher salary structure, is seen in Table 4. While all sectors experienced increases in the number of establishments, services grew faster than retail and goods producers and, within services, the largest category—professional—experienced substantial gains.

It is also apparent that the City's economy has become more diversified and its recent growth has been broad based. This balance across consumer and business service sectors has helped the City's economy to weather down turns in the business cycle better than economies that are more specialized.

Besides building an economy around its residentially based market potentials that would tend to support retail and consumer services, or building an economy dependent on the City's historic governmental functions, or its potential business linkages with George Mason University, the City has benefited from the growth of federal contracting in the Washington area that has been disproportionately concentrated in Northern Virginia and Fairfax County. While the federal spending data that are available are not conform precisely to the City's political boundaries, the trends shown for what is identified as Fairfax City Area confirm the magnitude of this spending and its growth pattern since 2000.

Table 4

The Changing Mix of Fairfax City's Business Base, 2000-2006
(number of establishments)

Business Classification	2000	2006	% Change
Goods Producing*	200	219	9.5
Retail Trade	212	224	5.7
Services	1,619	1,843	13.8
Finance and Insurance	208	231	11.0
Real Estate	85	106	24.7
Professional	689	792	14.9
Administrative	137	138	0.7
Educational	23	31	34.8
Health Care	190	210	5.3
Arts & Entertainment	17	27	58.8
Hotels/Restaurants	120	151	25.8
Other Services	150	157	4.7
Other Establishments**	181	164	- 9.4
Total	2,212	2,450	10.8

U.S. Census County Business Patterns, 2000-2006.

* construction and manufacturing firms.

**includes utilities, wholesale trade, transportation and warehousing, information, management companies, and unclassified establishments. This latter grouping accounted for all of the loss.

Between 1990 and 2000, the value of federal procurement contracting captured by firms located in the Fairfax City Area increased by a factor of 10 to \$2 billion and then have ranged around \$2 billion peaking in 2003 at \$2.76 billion, when spending associated with the "War on Terrorism" was accelerating, and has recently dropped back to \$1.9 billion in 2008. These federal procurement outlays are presented in Table 5.

Federal contractors are and will continue to be a major economic force in the Washington area economy and Northern Virginia locations have successfully attracted approximately one-half of the contractors located in the metropolitan area with Fairfax County ranking first in the country based on the value of federal procurement dollars received. With continuing growth projected for federal procurement dollars flowing into the local economies, targeting new and/ re-locating federal contractors for location in Fairfax City will help to expand the office market in the City and attract higher-value added jobs to its employment base.

Table 5

Federal Procurement Spending in the Fairfax City Area
1990, 2000-2008
(in billions of dollars)

Year	Fairfax City Area	Fairfax County*
1990	\$0.251	\$2.257
2000	2.029	6.667
2001	2.155	7.175
2002	2.325	7.961
2003	2.758	10.328
2004	2.451	12.820
2005	2.507	13.212
2006	2.294	14.034
2007	1.833	13.668
2008	1.916	16.725

Sources: U.S. Census, GMU Center for Regional Analysis

*excluding the Cities of Falls Church and Fairfax

Fairfax City's Economic Outlook

In the short term, the Fairfax City economy will struggle to sustain its continued growth during 2009 but is expected to grow through the national recession as its residential market potential will remain strong as will its federal contractor base. Still, there will be business failures and downsizing. Over the longer term, however, the City's strategy to strengthen its residential base and by doing so to expand its "home grown" economy by attracting higher income households to increase the local market potential for retail and consumer services will result in increased vitality within the City's center and other retail districts. Continuing expansion of GMU will also enlarge the City's market potential for retail and consumer services as well as for its professional and business services.

2010 will be a transition year for the City's economy resulting in some consolidation and some redirection. As the regional and Northern Virginia economies accelerate into 2010 and resume more normal growth patterns in 2011 and 2012, the City's economy also will return to normal. Key to the full redevelopment of the City center will be the attraction of (1) office uses to strengthen the weekday daytime retail

market and (2) infill residential development to augment the City center's evening and weekend retail markets.

The expansion of the City's office market will follow the office market's recovery from overbuilding throughout Northern Virginia in 2007 and 2008. It will take several years to absorb the available office supply. By 2011, however, new capacity will be required and the City should aggressively support the development of high quality multi-story but smaller structures to compete for small and mid-sized technology-intensive firms that would prefer the City's location and identity to the large footprint structures lining the Dulles Toll Road and Rt. 28 or available in Tysons Corner. The niche office market offers Fairfax City an opportunity to distinguish itself from its competitors. The City should also encourage and support mixed-use projects that include retail, office and residential uses.

Fairfax City's future economic vitality is dependent on maintaining its uniqueness as a place in which to live and work and to enjoy the benefits of small city life in the midst of a large metropolitan area. These qualities should be marketed to potential residents, investors, entrepreneurs, and small and mid-size businesses. There is a place for just about any type of business within the City. The challenge is to preserve the "right" places for the different types of businesses that might consider location in the City and to have the courage to be selective. Not all businesses or scales of housing development will fit or be appropriate in all locations.

The key for Fairfax City is to understand its strengths and weaknesses and to build on its strengths and to mitigate its weaknesses where possible. It has been the City's strengths that have enabled it to achieve the vitality, diversity, and resilience found in its economy today.

The City's economy will grow in coming years just because of its location in Fairfax County and because of the growth forces surrounding the City. In order to manage these inevitable growth forces, the City needs a carefully crafted economic development plan. This plan should provide for the continued expansion of the City's residentially based economy—this would further strengthen the City's retail base. Small-scale office development should be directed to the City center while larger scale offices should be directed to the City's major arterial highways. And, the City should continue to strengthen its positive image as a good place to live and work as this distinctive sense-of-place and identity will be increasingly important in the future as Northern Virginia becomes more urban and intensively developed.